The fine line between debt restructuring and bankruptcy proceedings

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Introduction

Under Swiss law, a company in financial distress which has some hope of rescue through restructuring measures can request a temporary composition moratorium with the competent debt restructuring court. A creditor that can request the opening of bankruptcy proceedings is also entitled to request the court to grant a temporary composition moratorium as an alternative.

The debt restructuring court will reject this temporary composition moratorium request if it is obvious that there is no prospect for a restructuring (with or without a composition agreement with the creditors). In such a case, the court will directly and automatically open bankruptcy proceedings over the company and the company will be liquidated.

If the debt restructuring court grants the temporary composition moratorium, the court will appoint a temporary trustee who will be in charge of the restructuring proceedings. The trustee will then take the first measures to identify the assets and debts of the company and monitor the company's actions. The maximum duration of a temporary composition moratorium is four months. Swiss law does not allow appeal against the decision to grant the temporary composition moratorium and appoint the trustee.

If during the temporary composition proceedings the court finds that there is a prospect for debt restructuring or a composition agreement, it will convene an oral hearing and can grant a final composition moratorium for an additional four to six months. The company and, if applicable, the creditor that requested the composition moratorium must be invited to the hearing. However, if the court assesses that there is no prospect for a debt restructuring or a composition agreement, the court will directly and automatically open bankruptcy proceedings over the company and the company will be liquidated.

Two recent Federal Supreme Court cases demonstrate that the two stages where the debt restructuring court assesses the prospects of restructuring are crucial, because the lack of such prospects may automatically lead to the bankruptcy and liquidation of the company.

Revocation of temporary composition moratorium

On November 11 2016 the Federal Supreme Court(1) upheld a decision of the first-instance district court in which the revocation of the temporary composition moratorium was ordered based on the lack of prospect of a restructuring before the moratorium period elapsed. This revocation of the temporary composition moratorium led to the automatic opening of bankruptcy proceedings.

The Federal Supreme Court held that the decision regarding whether to grant a final composition moratorium must be taken before the end of the temporary composition moratorium. Therefore, the

district court was entitled to use its power of discretion to set the court hearing for two weeks before the end of the temporary composition moratorium.

The court also confirmed that the company – which merely asserted many times during the temporary composition moratorium that it would soon receive funds for a restructuring without giving any evidence for it – had been unable to prove the prospects of debt restructuring. Therefore, by setting a court hearing date two weeks before the end of the temporary composition moratorium, the first-instance court did not violate any rights of the company.

The court found that the opening of the bankruptcy proceedings was correct and lawful and rejected the appeal.

Appeal againts final composition moratorium

In another case, the auditor of a company informed the judge about the company's over-indebtedness. In parallel, a creditor requested the debt restructuring court to grant a temporary composition moratorium. The first judge decided to stay the proceedings until the court's decision. The court then granted the temporary composition moratorium and appointed a trustee. Later, the court deemed that there was no prospect for a debt restructuring or moratorium agreement and revoked the temporary composition moratorium and opened bankruptcy proceedings.

The company appealed but the court of appeal rejected the appeal. The Federal Supreme Court finally confirmed the first-instance decision on September 29 2016.(2)

The company argued that the creditor that requested the temporary composition moratorium had no right to do so. However, the court of appeal held that the company was no longer entitled to challenge the creditor's right to request at this stage of the proceeding. The Federal Supreme Court did not share this view and deemed that the argument could be brought up in an appeal against the opening of the bankruptcy, as the company had no right to appeal the decision to grant the temporary composition moratorium. However, this finding did not help the company, as the Federal Supreme Court held that the company failed to prove that the creditor that had initiated the composition moratorium proceedings in the first place had no right to do so.

In the end, the Federal Supreme Court rejected the company's appeal because it deemed that the company had no prospect of restructuring and that the opening of bankruptcy proceedings was justified. For instance, the company had not even filed an audited balance sheet.

Comment

These two cases demonstrate that even though the debt restructuring proceedings may be a good solution to restructuring a company, the company or creditors requesting a formal restructuring proceeding must be certain that there is a prospect for debt restructuring and have evidence to prove this. Therefore, if the company has a real chance of survival, it is advisable to collect all evidence proving the prospect of debt restructuring before initiating proceedings, as any premature request carries the risk that the debt restructuring court will find no prospect of restructuring.

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Endnotes

(1) Decision 5A_495/2016, see www.bger.ch (in German).

(2) Decision 5A_950/2015, see www.bger.ch (in French).